FILE COPY

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1959

No. 513

UNITED STATES OF AMERICA,
Petitioner,

vs.

CANNELTON SEWER PIPE COMPANY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

The sole issue in this case is the basis for computing the percentage depletion allowance to which the taxpayer is entitled under the provisions of the Internal Revenue Code of 1939 because of the taxpayer's mining and processing of clay. Under the provisions of the Code, taxpayer's percentage depletion deduction is to be computed as a percentage of "gross income from the property" which the Code

specifically defines as "gross income from mining". The allowance, however, may not exceed "50 per centum of the net income . . . from the property". The Code[1] then specifically broadens the meaning of "mining" as generally understood;

> "The term 'mining' as used herein shall be considered to include *not merely* the extraction of the ores or minerals from the ground *but also* the ordinary treatment processes normally applied by mine owners or operators in order to obtain the *commercially marketable mineral product or products* . . ." (Emphasis supplied)

The taxpayer produced burnt clay products (principally vitrified clay sewer pipe) from fire clay and shale which it mined from its underground mine. The taxpayer sold no raw fire clay or shale, nor could it have done so.

The question presented is whether the gross income from the sale of the finished commercially marketable products sold by the taxpayer is the proper base for computation of the percentage depletion allowance or whether that base must be a hypothetical gross income ascribed to raw clay which taxpayer could not commercially market.

STATEMENT

Taxpayer, Cannelton Sewer Pipe Company, was engaged near Cannelton, Indiana in mining from an underground mine fire clay and shale during 1951, the taxable year in suit, and taxpayer mined 38,473 tons of clay, in the proportions of 60% fire clay and 40% shale, all of which it processed into vitrified clay sewer pipe and related burnt clay

[1] Internal Revenue Code of 1939, Section 114(b)(4)(B), set forth in the petition, p. 33.

products, except for a negligible 80 tons of ground fire clay and shale which it sold in bags. (R. 5)

At no time did taxpayer ever sell any of its raw fire clay or shale nor has it ever purchased any fire clay or shale for use in its production of said products; there was no market for the fire clay and shale mined by taxpayer before it was processed into said products, except for negligible amounts of ground fire clay and shale. (R. 5, 6) As the Court below held, the first commercially marketable mineral products of the fire clay and shale mined by plaintiff during the year in question were its said burnt clay products. (R. 6)

The Court below found (R. 5) and the Court of Appeals recognized that "there is no contention here that the instant taxpayer applied other than normal treatment processes in obtaining its finished products."

The Circuit Court found that at Brazil, Indiana, 140 miles away from the taxpayer, substantial quantities of fire clay were sold during the taxable year, 1951, either by strip-miners of coal who sold the underclay as a by-product or by those who mined underclay which had already been laid bare by coal strip-mining operations. The Court pointed out, however, that of 82 companies in Indiana who mined or used fire clay or shale, only 7 miners of fire clay and 2 miners of shale sold the clay in the raw form rather than processing it into finished clay products and that "The evidence the Government used to establish the existence of a market for taxpayer's fire clay indicates, in fact, that the integrated miner-manufacturer was the rule rather than the exception in Indiana, in 1951." (Pet. App. A, p. 28). The Court also pointed out that the mining costs of strip-miners was considerably less than those of taxpayer who operated an underground mine, and that several of the miners at

Brazil could not find a market for all of the clay which they had available for sale.

The raw fire clay sold at Brazil, Indiana ranged from $1.60 to $1.90 per ton delivered in the Brazil area. Taxpayer's mining cost alone was $2.41 per ton. But even if taxpayer could have mined its clay for nothing, the evidence showed that the transportation cost alone for hauling taxpayer's clay to Brazil was $4.58 per ton by rail freight and from $5.50 to $6.00 per ton in taxpayer's experience (R. 119, 120) to $15.20 per ton in the experience of one of the Government witnesses if hauled by truck (R. 283). This transportation cost eliminated Brazil completely as a commercial market for taxpayer's fire clay and shale.[2]

On the basis of these facts, the Court of Appeals concluded (Pet., App. A p. 27): "that it (taxpayer) did not have a *commercially* marketable product in its fire clay and shale", and that it was entitled to compute its percentage depletion allowance on the basis of its selling price of its burnt clay products.

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[2] In Footnote 4 at page 5 of the Government's petition, it is stated that raw fire clay and shale were sold across the river from taxpayer in Kentucky. This statement refers only to the fact that one Frank Chapman had a contract with a manufacturer of sewer pipe to mine and haul fire clay and shale from lands owned by the manufacturer at a contract price per ton. The witness stated unequivocally that he had never sold any raw clay and he knew of no one in that area who did mine and sell raw clay. (R. 225)

ARGUMENT

I

There is no conflict among Circuit Courts of Appeal as to the decision in this case.

Taxpayers have prevailed in six Circuit Courts of Appeal[3] in regard to the construction of the statutory language involved in Section 114 (b)(4)(A) and (B) of the 1939 Code. There has been no conflict among the decisions by such courts, and no claim of any such conflict is made by the Government in its petition in this case.

II

The Government's petition presents no important question of Federal law which needs to be decided by this Court.

The question in this case is solely one of statutory construction. The same statutory language has been construed by six Circuit Courts of Appeal. Seven Circuit Court opinions have been written, with a total of twenty judges participating. There has not been a single dissent.

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[3] *United States* v. *Cherokee Brick & Tile Company*, 218 F. 2d 424 (5th Cir. 1955), as to brick and tile clay; *Townsend* v. *The Hitchcock Corporation*, 232 F. 2d 444 (4th Cir. 1956), as to pulverized talc and talc crayons; *United States* v. *Sapulpa Brick & Tile Corporation*, 239 F. 2d 694 (10th Cir. 1956), as to brick and tile clay; *Dragon Cement Company, Inc.* v. *United States*, 244 F. 2d 513 (1st Cir. 1957), cert. denied 355 U.S. 833, as to cement rock; *United States* v. *Merry Brothers Brick & Tile Co.*, 242 F. 2d 708 (5th Cir. 1957) cert. denied 355 U.S. 824; as to brick and tile clay; *United States* v. *Cannelton Sewer Pipe Co.*, 268 F. 2d 334 (7th Cir. 1959), as to fire clay and shale; *Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398 (8th Cir. 1959), as to chemical grade limestone.

All of these courts have held that the statute is "clear and unambiguous". All of the arguments made by the Government in an attempt to restrict the plain meaning of the statute have been carefully considered and rejected. Since the decision was made in the instant case, the opinion of the 7th Circuit Court of Appeals has been considered and approved by the Court of Appeals for the 8th Circuit in *Commissioner* v. *Iowa Limestone Company*, 269 F. 2d 368, by the Tax Court of the United States in *Halquist* v. *Commissioner*, 33 T.C. No. 36 (Nov. 25, 1959),[4] and in four District Court cases in Pennsylvania, Alabama, and California.[5] Prior thereto, the statute had been construed against the Government's theories by the Tax Court of the United States and by District Courts in nine Circuits.

Such unanimity of opinion among the scores of judges who have considered the statute certainly cannot lead to a conclusion that the issue here present can only be settled by this Court. The issue has been settled so completely that no other decision should be necessary.

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[4] On November 25, 1959, three weeks after the filing of the petition for certiorari in the present case, the Tax Court of the United States filed an opinion in the cited case which involved the same questions presented in this case. The taxpayer there mined dolomite and processed it into the products which it sold. The Court held that the gross income from these products represented the base on which the taxpayer should compute its percentage depletion and carefully considered and fully approved both the *Cannelton* and *Iowa Limestone* opinions. In view of the fact that the opinion is not yet published, we attach an excerpt from it as Appendix A, in which the statute and cases are analyzed.

[5] *Standard Clay Mfg. Co.* v. *United States*, (D.C. Pa. 1959) 59-2 U.S.T.C. 9585; *Dixie Fire Brick Co.* v. *United States*, (D.C. Ala. 1959), 59-2 U.S.T.C. 9625; *Victorville Lime Rock Co.* v. *Riddell* (D.C. Cal. 1959) 59-2 U.S.T.C. 9651; *Eastvale Clay Products Co.* v. *United States*, (D.C. Pa. 1959) 59-2 U.S.T.C. 9682.

III

The Government relies on the same grounds unsuccessfully urged in other cases where certiorari was denied.

More than two years ago, this Court denied petitions for certiorari in the cases of *United States* v. *Merry Brothers Brick and Tile Company*, et al., Oct. Term 1957 No. 220, Cert. denied 355 U.S. 824 and *United States* v. *Dragon Cement Company, Inc.*, Oct. Term 1957 No. 301, Cert. denied 355 U.S. 833. The Government makes an attempt to show that the issue present in this case is different from that which was present in the prior petitions for certiorari in the Merry Brothers group of cases (Pet. 12-14).

The Government's attempt to show a difference in issue is based on the proposition that the statute "poses two problems: (1) What is included in the phrase 'ordinary treatment processes'? (2) How does one determine the identity of the 'commercially marketable mineral product'?" (Pet. p. 12) It then states that the first question was decided against the Government in the Merry Brothers group of cases and that the second question was not decided and is present here. We disagree. We believe it is inherent in construing this statute in the Merry Brothers group of cases that the "commercially marketable product" of the particular taxpayer involved was determined before any question regarding the treatment processes was decided. The statute requires, and the courts so found in the Merry Brothers cases that finished brick and tile, sewer pipe and related products were the "commercially marketable mineral products" of each particular taxpayer involved in such cases where the evidence showed that the taxpayer had no commercial market for its clay; just as

in the present case, the Court of Appeals held that taxpayer "did not have a commercially marketable product in its fire clay and shale", and that the finished sewer pipe was its first such product.

The factual distinction offered by the Government between the *Merry Brothers* cases and the present case is that the prior decision involved only operators who "extracted brick and tile clay (to be distinguished from fire clay) and made it into brick." (Pet. p. 13) *This is clearly a mis-statement of fact.* — The Merry Brothers petition involved a total of 13 cases which had been decided by the Court of Appeals for the 5th Circuit dealing with the depletion deduction for operators who mined brick and tile clay, *shale* and *fire clay*, and who processed such raw material into brick, tile, sewer pipe and other related burnt clay products. Two of the cases in the Merry Brothers petition involved fire clay [6] this being one of the minerals involved in the present case. In still another case involving fire clay, the Government stipulated that it should be affirmed by the Fifth Circuit if certiorari was denied in the *Merry Brothers* case.[7]

In each of the fire clay cases, the Government introduced

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[6] *Acme Brick Co.* v. *United States* 167 F. Supp. 911 (N.D. Tex. 1956), aff'd 57-1 U.S.T.C. 9617 (C.A. 5, 1957), cert. denied 355 U.S. 824; *Elgin-Butler Brick Co.* v. *United States*, 146 F. Supp. 378 (N.D. Tex. 1956), aff'd, 57-1 U.S.T.C. 9619 (C.A. 5, 1957), cert. denied 355 U.S. 824. This was fully recognized by the Government in the petition for certiorari in the *Merry Brothers* case where in Footnote 20, p. 21 of the petition it said: "For example, in two of the instant cases (*United States* v. *Acme Brick Co.*, and *United States* v. *Elgin-Butler Brick Co.*) involving fire clay, mined in Texas, the first commercial product was not reached until the mineral had been converted into burnt brick and tile."

[7] *Elgin-Standard Brick Mfg. Co.* v. *United States*, 153 F. Supp. 279, W.D. Tex. 1957), aff'd, 58-1 U.S.T.C. 9115 (C.A. 5, 1957).

evidence in an attempt to show that fire clay had a market in the form of raw clay. Each of the District Courts, however, found that while at some places in the United States there was a commercial market for raw fire clay, these markets were not available to the taxpayer involved because of heavy transportation costs, that there was no commercial market for the fire clay of the particular taxpayer except in the form of burnt clay products, and that somewhere between 75% and 90% of all of the output of fire clays in the entire United States are not commercially marketable until they are put in the state of finished, burnt clay products such as fire brick, tile, structural tile, sewer pipe and other products. The Courts further found that 90% of all of the miners of fire clay in the United States have to process the fire clay into finished products before there is any commercially marketable product.

The government's statement in the petition (Pet. p. 15) that "It cannot be ordinary or normal for miners of fire clay—*itself, a marketable product*—to apply those processes which are used by manufacturers of sewer pipe" (emphasis supplied) contradicts the findings in the *Acme Brick* and *Elgin-Butler* cases that in the entire United States it is the *normal* thing for miners of fire clay to process the clay into finished burnt clay products. The same findings were made by both of the lower courts in the present case that this taxpayer could not sell its fire clay and shale until it was processed into finished burnt clay products.

Another case in the Merry Brothers group involved only shale,[8] and figures from the Bureau of Mines identical to those introduced in the *Merry Brothers* case were intro-

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[8] *Texas Vitrified Pipe Co.* v. *United States*, No. 3329, (N.D. Tex. Feb. 1957) aff'd, C.A. 5 May 19, 1957, cert. denied 355 U.S. 824.

duced in evidence. Thus the prior petition for certiorari filed in the Merry Brothers case did include cases involving both of the minerals and the finished products now involved in the present case.[9] The Government stated to this Court in its petition for certiorari in the *Merry Brothers* case that "the facts and issues in the remaining cases are in all material respects the same as in the *Merry* and *Reliance* cases."[10]

The Government at the time of the Merry Brothers petition recognized the inevitability of the proposition that a decision for the taxpayer in that case required a similar decision in the case of fire clay and shale. Not only did it in effect so state to this Court,[11] but the proposition appeared to be so clear that the Government did not even wish to argue the *Acme* and *Elgin-Butler* cases in the Court of Appeals, but on the contrary stipulated that the cases should be affirmed without briefs or argument in the event the *Merry Brothers* decision was affirmed. Under such circumstances, it is surprising to find the government here

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[9] In the petition in this case, in a footnote to the decision of the Court of Appeals attached as Appendix A thereto, it is pointed out specifically that three of the cases covered by the Merry Brothers petition involved fire clay. (Pet., p. 31.)

[10] See Petition for Writ of Certiorari in *United States* v. *Merry Brothers Brick and Tile Co.*, et al, Oct. Term 1957, No. 220 at p. 7. The Government took advantage of Rule 23-5 of the revised rules of this Court by alleging in its petition that "all 13 cases involved substantially identical questions".

[11] Merry Brothers Petition (pp. 20-21): "Under the reasoning of the court below, the statutory basis for percentage depletion ('gross income from mining') will differ markedly as between taxpayers who mine one type of mineral rather than another, and *as between taxpayers who, although they are engaged in mining the same type of mineral, do their mining in different localities.*" (Emphasis supplied.)

urging as worthy of consideration by this Court an argument which has the same factual basis as was present in the prior cases presented to this Court but with the merit of which it was so little impressed as not to have presented to either the Court of Appeals for the 5th Circuit or to this Court in the Merry Brothers petition.

The Government also states that in the Merry Brothers petition the sole issue was whether manufacturing processes could be included within the term "mining" as used in the statute and that such question is not present here. However, in the present petition, the Government cannot make its argument without continually referring to "integrated miner-manufacturer", "finished manufactured products", and even says on page 6 of the petition: "What is at stake is ultimately this—May the deduction for depletion of mineral deposits, adopted on the theory that there should be an allowance for the exhaustion of a wasting asset, be converted into a prodigious tax benefit, available to selected taxpayers, for their *manufacturing activities?*" Thus the present petition recognizes that a decision cannot be made without again arguing the distinction between mining and manufacturing processes even though it recognizes that that issue was settled by *Merry Brothers* (Pet. p. 13).

The arguments raised in the present petition relating to discrimination, inequities,[12] and incongruities and as to the large impact upon the revenue[13] are in substance the

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[12] Of course, under the statute there will be some variation among producers of the same mineral, due to differences in local prices, products produced, net income, royalties paid, etc. Such variations are inherent in percentage depletion as this Court recognized in *Helvering* v. *Mountain Producers Corporation*, 303 U.S. 376, 381 (1938).

[13] Although two years have passed since denial of the petition for certiorari in Merry Brothers, it is shown in Table 1, Appendix C

same as those urged in the Merry Brothers petition and have since been urged in hearings before the Ways and Means Committee of the House of Representatives in an effort to have the marketable product test eliminated from the statute.

What the Government's argument really boils down to is: (1) the statute is too generous in that it results in a "prodigious tax benefit" and "the impact on the revenue is enormous" and (2) the *statute* is unfair in that it creates discrimination and results in unfair competition as between certain taxpayers. Assuming, arguendo, that these arguments are sound, they present a case for the Congress to investigate; but surely, they present no justiciable issue in regard to statutory construction which can only be resolved by the Supreme Court of the United States.

IV

The question raised in the petition is one for Congress—not for the Courts.

The courts, before and after the Merry Brothers decision, have been in agreement that the complaints of the Government against the construction of the statute now approved by this overwhelming body of unanimous judi-

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attached to the petition for certiorari in this case that there are still pending 82 cases involving brick and tile clay. It appears obvious from this that the Government has not given up on the Merry Brothers decision and would like to reargue it here. This is equally obvious from the fact that in attempting to show the so-called "potential tax loss resulting from the extension of percentage depletion to manufactured products," the Government in its Appendix C does not even attempt to segregate the alleged loss arising from the result in the Merry Brothers decision from the alleged loss resulting from the decision in this case.

cial decisions are complaints properly to be addressed to Congress and not to the courts.[14]

Immediately after the denial of certiorari in Merry Brothers, the Treasury went to Congress and asked for repudiation not only of the decisions as to brick and tile clay and cement rock, but also of the decisions as to fire clay.[15] This was in January, 1958. In January, 1959, the Treasury again went to Congress complaining of the results of these decisions and urging upon Congress the complete elimination from the statute of the "commercially marketable product" test which has prevailed for so long, even submitting a specific draft of a proposed amended Section 114(b)(4)(B) of the Code. Five days of hearings dealing with the subject were held by the Ways and Means Committee in March, 1959,[16] and another panel discussion before the Committee is set for December 1, 1959. The Treasury has placed before Congress all of its complaints

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[14] For example, Chief Judge Magruder stated: "The allowance for depletion has been a controversial subject for years, and officials of the executive branch have sought from time to time, with conspicuous lack of success, to persuade the Congress to eliminate some of its alleged overgenerous features. We are not concerned with the wisdom or policy of the statutory allowance, once we are sure what the allowance is, for it is plainly our judicial function merely to apply the allowance as Congress wrote it and meant it." *Dragon Cement Co. v. United States*, 244 F. 2d, 513, (C.A. 4, 1957).

[15] In the case of fire clay made into brick and tile, it requested not only a change of the cutoff point but also a reduction in rate from 15% to 5%.

[16] The arguments made by the Government in the present petition were presented to the Congress by Mr. David A. Lindsay, Assistant to the Secretary of the Treasury. Certain reactions by some of the Congressmen are illuminating in regard to the positions advanced in this petition and the same are attached to this brief as Appendix B.

about the present statute and has had a full opportunity to urge upon Congress the substitute provisions which it desires.

The wisdom of leaving the Government's complaints for Congress to review is readily apparent from the arguments advanced in its present petition. The arguments based on administrative convenience and equity among taxpayers illustrate the point.

In its petition the Government argues that the "rule adopted below is one which creates virtually insuperable administrative problems." But the position for which the Government contends here would instead impose upon the individual taxpayer (as well as the Commissioner) the "virtually insuperable" problem of determining a "market" price of raw minerals sold in different places in the country at different prices but for which the taxpayer had no market. If there is in fact any countervailing consideration of administrative convenience in the Government's position, the balancing of those considerations is clearly a matter for the Congress.

A similar problem of legislative policy is involved in the Government's argument that the decisions below favor the present taxpayer over nonintegrated miners of fire clay and shale. The Government fails to point out, however, that the adoption of its theory would work gross discrimination as between this taxpayer and integrated miners of *brick and tile clay*. The latter admittedly receive a depletion allowance based on the selling price of their finished burnt clay products since they cannot sell their clay in raw form, while the allowance for the taxpayer here—who likewise cannot sell its raw fire clay and shale—would be based on a hypothetical selling price of its *raw* minerals. Here again, any departure from the rules laid down in the prior cases would require a careful reexamination of the statutory policy which should be left to Congress. The fact that Congress (and the Treasury) have had the broad problems

of percentage depletion under extensive review simply underscores the wisdom of this course.

As the Government itself has said in successfully opposing a petition for certiorari in a case involving another complicated area of federal taxation:

> "The complicated problems involved are under continuing administrative and legislative study. This would seem to be a persuasive factor, in addition to those already stated, militating against further review at the present time of the question sought to be raised in this case." [17]

CONCLUSION

In conclusion, therefore, we respectfully submit that the present petition presents no important question which can only be resolved by a decision of this Court in view of the unanimity of decision in six Courts of Appeal and the Tax Court of the United States, and also in view of the fact that the factual situation on which the petition is based was present in the *Merry Brothers* cases in which this Court denied certiorari two years ago. Furthermore, if there ever was a case where the objections raised by the Government to a statute are peculiarly within the jurisdiction of Congress rather than the courts, this is such a case.

The petition for certiorari should be denied.

Respectfully submitted,

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NOVEMBER, 1959.

[17] Brief for Respondent in Opposition (pp. 13-14) in *Moe* v. *Earle*, October Term, 1955, No. 639, cert. den. 350 U.S. 1013.

APPENDIX A

The following is an excerpt from the opinion of the Tax Court of the United States filed on November 25, 1959 in the case of *Halquist* v. *Commissioner* 33 TC No. 36; (footnotes omitted):

"With the objective of providing a simplified method of computing depletion allowances which would avoid the complications and difficulties arising in connection with cost and discovery depletion, Congress in 1936 introduced percentage depletion based on 'gross income from the property.' The ambiguity inherent in the phrase 'gross income from the property' and the disputes arising therefrom led to the enactment in 1943 of the definition found in subsection (B) of section 114(b)(4), which has been carried substantially intact through the 1954 Code. Although it then became clear that the gross income upon which the depletion allowance was to be based was to include income derived from processes that went beyond mere extraction of the mineral from the ground, the basis for disputes had not been eliminated—it shifted in focus to the interpretation of the new phrase 'ordinary treatment processes normally applied by mine owners and operators in order to obtain the commercially marketable mineral product or products * * *.'

"It was soon settled that 'commercially marketable mineral product' meant the *first* commercially marketable mineral product resulting from the application of ordinary treatment processes. *International Talc Co.*, 15 T.C. 981; *Black Mountain Corporation*, 21 T.C. 746; *Riverton Lime & Stone Co.*, 28 T.C. 446.

"In an effort to limit the scope of 'mining' as defined in subsection (B), however, the Commissioner persistently attempted to distinguish and draw a line between extraction processes and manufacturing processes, arguing that the latter were not allowable 'ordinary treatment processes.' The courts rejected this

effort. In *United States* v. *Cherokee Brick & Tile Company*, 218 F. 2d 424 (C.A. 5); *United States* v. *Merry Brothers Brick and Tile Co.*, 242 F. 2d 708 (C.A. 5), certiorari denied 355 U.S. 824; and *United States* v. *Sapulpa Brick and Tile Corporation*, 239 F. 2d 694 (C.A. 10), contrary to the Commissioner's contention that the processes by which raw clay was transformed into burnt brick and tile were unallowable manufacturing processes, it was held that fully processed brick and tile were the first commercially marketable products from the mineral involved, and that all of the processes utilized to obtain this product were ordinary treatment processes. *Dragon Cement Company* v. *United States*, 244 F. 2d 513 (C.A. 1), certiorari denied 355 U.S. 823, held that manufactured cement, involving a chemical change in the processing of the raw mineral, was the first commercially marketable product from cement rock. *Riverton Lime & Stone Co.*, *supra*, held that hydrated hydraulic lime was the first such product from a limestone mine. In *Townsend* v. *Hitchcock Corporation*, 232 F. 2d 444 (C.A. 4), pulverized talc and talc crayon were found to be the commercially marketable products obtained from ordinary treatment processes, regardless of whether they may be considered to be 'manufactured' products. These and other courts were of the uniform opinion that the statutory language was clear and unambiguous, and that gross income from mining included the income from all processes ordinarily and normally applied to obtain the first product marketable in commerce. The depletion allowance not being an allowance upon any processes as such, did not necessitate distinguishing between mining processes and manufacturing processes.

"Shifting his emphasis now to a new theory which would restrict the scope of the depletion allowance, respondent here argues that the first commercially marketable mineral product in any particular mining industry is the crudest, least-processed product for which a commercial market exists in the United States in more than negligible quantities, and that the proc-

esses utilized and normally applied by mine owners and operators in that industry to produce this crudest marketable product are the only processes which can be considered to be ordinary treatment processes within the meaning of the statute. To ascertain the crudest, least-processed, yet marketable, product for the particular mineral industry involved, respondent would look to the country as a whole. Once the product base had been determined for an entire industry it would serve as the standard for all of the producers of that mineral, notwithstanding that an individual miner or operator may not produce or market it or be capable of marketing it at a profit. Those who processed and marketed a product other than the standard industry product would be required to utilize as their depletion base a gross income reconstructed by reference to the representative market price of the crudest, least-processed marketable product from a mineral of like kind and grade, or if there is no such market price, respondent would allocate and eliminate on the basis of costs all income attributable to processes beyond those necessary to produce the crudest product.

"For the dolomite and limestone industry, then, respondent shows that the crudest, least-processed product marketed in more than negligible quantities is crushed and broken stone. The processes normally applied by limestone and dolomite operators to obtain crushed and broken stone, respondent contends, are the only 'ordinary treatment processes' contemplated by the state. This would be so in spite of the variety of products which may be and are in fact produced from a limestone or dolomite mine. Thus in petitioner's case the gross income from the sales of their crushed stone would all be includible in the depletion base. On the other hand, respondent insists, income from the sale of building or dimension stone, a more highly-refined product utilizing processes quite different from those required to produce crushed stone, would be excluded to the extent of the income attributable to the additional processing steps—that is, in-

come from the sale of building stone must be limited to the income that would have been derived if such stone had been sold as crushed and broken stone.

"The so-called 'least-processing' theory appears to have first been advanced by respondent before the Seventh and Eighth Circuits in his appeals from the district court's decision in *Canfelton Sewer Pipe Co.* v *United States*, 268 F. 2d 334 (C.A. 7), and from this Court's decision in *Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398 (C.A. 8), affirming 28 T.C. 881, both of which were still pending when the case here before this Court was submitted. Since then both appellate tribunals have handed down their decisions and both totally rejected respondent's interpretation.

"In *Canfelton*, the taxpayer mined fire clay and shale and manufactured therefrom vitrified clay sewer pipe and related products. The income derived from the sale of his fully processed products was used as his basis for depletion. The Government urged that since there was an existing substantial market for raw clay and shale in the immediate area, as well as in the State of taxpayer's mine, the raw unprocessed mineral was his first commercially marketable product. The Court pointed out that taxpayer's mining costs alone, due to a more expensive underground type of operation, exceeded the current selling price of raw clay and shale, and in view of this fact was unable to understand how raw clay and shale could be considered commercially marketable products for this particular taxpayer. In the Court's view, taxpayer had to be in a position to sell his product at a profit before it was 'commercially marketable,' and in order to achieve this end, taxpayer found it necessary to further process his raw material into vitrified clay sewer pipe. The evidence also showed that integrated mining and manufacturing operations wherein the raw material was processed by the mining operators into a finished product was the rule rather than the exception in taxpayer's area in the year involved, and that the treatment processes used to obtain his finished prod-

ucts were ordinary and normal. In rejecting respondent's contention that there can be only one depletable or commercially marketable product for each mineral, the Court said:

> The short answer to this is that we do not agree that it was intended that the depletion allowance for each mineral be reduced to the common denominator represented by a conceivable product most cheaply produced from each mineral.

"Again respondent urged in *Iowa Limestone* that the crudest, least-processed product marketable from taxpayer's limestone quarry was crushed limestone, even though taxpayer marketed only finely ground or pulverized chemical grade limestone. Although there clearly was a market for crushed limestone for road and agricultural purposes and taxpayer's stone could have all been crushed and utilized for such purpose (as a minor amount of dirty and contaminated material was), his "deposit of limestone was a relatively rare and special type particularly suitable for chemical use. In its pulverized form processed for chemical use, the limestone was considerably more valuable and commanded a higher price than crushed stone. The Court was of the opinion that the taxpayer

> had the right to market its chemical grade limestone for the purpose for which it was most suited and in a field where it would command a fair price. Gold, silver, and iron ores and other valuable minerals could doubtless be sold for road rock, fill, or ballast, but no one would contend that their value must be determined upon such a limited use of such products. It was not economically feasible for the taxpayer to market its superior stone as ordinary road rock. Many kinds of cheap stone would equally serve such a purpose.

"While there are some differences in the facts in those two cases and in this case, the courts in those cases specifically rejected substantially every argu-

ment advanced by respondent in this case in support of his most recent theory, and we think the principles announced in those decisions are equally applicable here.

"In both of those cases the courts rejected the argument that the one most cheaply-produced product of the mineral that could be produced and sold at a profit by someone somewhere in the country was the commercially marketable product for all taxpayers in that industry, regardless of whether it was economically feasible for the particular taxpayer to produce and market that product at a profit. Both courts stated that the profit-making aspect must be given consideration in determining whether a mineral product is commercially marketable, and that the taxpayer has a right under the statute to market its mineral for the purpose for which it is most suited. We agree. *Riverton Lime & Stone Co., supra; Iowa Limestone Co.*, 28 T.C. 881."

APPENDIX B

In March, 1959, the Ways and Means Committee of the House of Representatives held extensive hearings on the very section of the Revenue Code of 1954 which is identical with the section now under consideration from the Revenue Code of 1939 at which time the Treasury presented all of its arguments in favor of removing the commercially marketable product test entirely and substituting therefor a cutoff point in the processing of minerals which supposedly stops the allowable processing at the conclusion of mining as distinguished from manufacturing. The hearings were printed as a report entitled "Mineral Treatment Processes for Percentage Depletion Purposes". The following excerpts relate directly to certain arguments advanced by the Government in the present petition which were also made by the Department of Treasury through David A. Lindsay, Assistant to the Secretary of the Treasury.

1. As to the argument concerning "loss of revenue" by reason of the interpretation which the courts have put upon the statute, Congressman Noah M. Mason had this to say: "The Treasury says it is a loss to the Treasury, $300 million or $100 million, or whatever it is. How can it be a loss to the Treasury if, when the actual law is applied, it gives this depletion allowance to the industry? How can the Treasury claim that is a loss if it belongs to the industries? Also, the Treasury refused to return or rebate the money they have collected, not according to law, but according to their rulings, and so now the industries have to sue to get their money back, money that belongs to them. That is the picture as it presents itself to me, and your testimony does not change that picture as I see it." (Report, p. 14)

2. As to the argument that the interpretation put upon the statute is in conflict with the theory of percentage depletion and that a depletion deduction is solely for the purpose of allowing a recovery of a capital investment, Congressman Howard H. Baker in examining Mr. Lindsay had the following exchange: "*Mr. Baker.* Now percentage depletion is statutory language. *Mr. Lindsay.* That is cor-

rect. *Mr. Baker.* I always understood that one of the basic reasons for percentage depletion was to encourage the mineral industries to plow money back into discoveries to find new fields so that natural resources would not be depleted when they are so needed in the national interest. That has been my understanding of the basic reasoning behind percentage depletion. Am I wrong on that concept? *Mr. Lindsay.* No; I think you are correct, Mr. Baker. *Mr. Baker.* That is really the basic reason? *Mr. Lindsay.* Yes." (Report, p. 27)

3. As to the argument that the present interpretation leads to uncertainty and terrific administrative problems, Congressman Richard M. Simpson made the following statement to Mr. Lindsay: "Certainly we have comparative stability. The Department has been told now by the courts just where depletion is to apply, the amount of money, based upon decisions at hand, is not too large, in my judgment. Certainly it is a small price to pay for stability in a field where cases have been hanging open for years, 6, 7, or 8 years, because we have not been able to reach an administrative decision. I think we might advisedly retain something that gives us an element of certainty rather than adopt the terrific uncertainty that we would find from the approval of a new approach to this question." (Report, p. 23).